



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Office of Public Instruction

*For the Two Fiscal Years Ended
June 30, 2007*

OCTOBER 2007

LEGISLATIVE AUDIT
DIVISION

07-19

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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Angie Grove

October 2007

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report for the Office of Public Instruction for the two fiscal years ended June 30, 2007. Our report contains two recommendations related to properly recording assets on the state's accounting system and noncompliance with state law related to its internal service fund. The office's written response to the audit recommendations is included in the back of the report.

We thank the Superintendent and her staff for their assistance and cooperation during the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

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ELECTED, APPOINTED, AND ADMINISTRATIVE OFFICIALS

Office of Public Instruction

Linda McCulloch, Superintendent

Dennis (Bud) Williams, Deputy Superintendent

Madalyn Quinlan, Chief of Staff

Kathleen Magone, Chief Legal Counsel

Nancy Coopersmith, Assistant Superintendent
Department of Education Services

Bob Runkel, Assistant Superintendent
Department of Education Services

Joan Anderson, Assistant Superintendent
Department of Operations

For additional information concerning the Office of Public Instruction, contact:

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REPORT SUMMARY

Office of Public Instruction

This financial-compliance audit report contains the results of our audit of the Office of Public Instruction (office) for the two fiscal years ended June 30, 2007. We issued an unqualified opinion on the financial schedules of the office for the two fiscal years ended June 30, 2007. The reader may rely on the financial information presented in the financial schedules and the supporting data on the state’s accounting system.

The prior audit contained two recommendations to the office. This report contains two recommendations for improving office compliance with state laws and policies.

The listing below serves as a means of summarizing the recommendations contained in the report and the office’s response thereto.

Recommendation #1

We recommend the office:

A. Implement procedures to ensure office personnel are aware of state policies related to recording assets.

B. Record all required accounting entries when recording intangible assets.....4

Office Response: Concur.....B-3

Recommendation #2

We recommend the office comply with state law by charging fees that are commensurate with costs.5

Office Response: Concur.....B-3

Chapter I — Introduction

Introduction

We performed a financial-compliance audit of the Office of Public Instruction (office) for the two fiscal years ended June 30, 2007. The objectives of the audit were to:

1. Determine if the office complied with applicable state and federal laws and regulations.
2. Obtain an understanding of the office's control systems to the extent necessary to support our audit of the office's financial schedules and, if appropriate, make recommendations for improvement in the internal and management controls of the office.
3. Determine if the office's financial schedules present fairly the results of its operations for each of the two fiscal years ended June 30, 2007.
4. Determine the implementation status of prior audit recommendations.

This report contains two recommendations to the office. Other areas of concern deemed not to have a significant effect on the successful operations of the office are not included in this report, but have been communicated to management. In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing the recommendations made in this report.

As required by section 17-8-101(6), MCA, we analyzed the rates charged and fund equity in the department's Internal Service Fund. The Internal Service Fund contains the office's indirect cost pool. We found the charges and fund equity were not reasonable for the operations in this fund in fiscal years 2005-06 and 2006-07. Recommendation two starting on page 4 addresses this issue.

Office Organization and Function

The Office of Public Instruction is established in Article VI, Section 1, of the Montana Constitution. The Superintendent of Public Instruction is an elected official responsible for the general supervision of K-12 public schools and districts within the state of Montana. In addition, the superintendent is the governing agent and executive officer for K-12 vocational education in the state.

The office, which is comprised of approximately 163 full-time equivalent employees, provides services to school age children and to teachers in more than 440 school districts. The staff furnishes technical assistance in planning, implementing, and evaluating educational programs. The office also oversees teacher preparation, teacher certification, school accreditation, school curriculum, school finance, and school law. The staff administers numerous federal grants and provides a variety of information services.

The office records its financial activity in the State Level Activities and Local Education Activities programs. The following paragraphs describe the activities accounted for in each program.

State Level Activities

The State Level Activities program is established for the delivery of state services and state and federal funds to schools. The staff of this program supports the superintendent's statutory role with the Board of Public Education, the Board of Regents, and the Land Board. In addition, program personnel administer several state programs, such as drivers' education, school food services, and audiology.

Within this program, the office oversees the financial reporting, cash management, and cost allocation functions for federal grants. These grants include: Title I; Child Nutrition and Commodities; Individuals With Disabilities Education Act, Part B (IDEA B); and Title II A. The program allocates centralized administrative costs of the office (payroll, personnel, accounting, budgeting, purchasing, word processing, and mail delivery) to both state and federal activities through the use of an approved indirect cost rate.

Local Education Activities

The Local Education Activities program is established to distribute state and federal funds to local education agencies, which are primarily schools. Schools receive distributions for state support to schools, special education, traffic education, and federal grants. Total distributions to local education agencies amounted to \$734,249,880 and \$801,972,756 in fiscal years 2005-06 and 2006-07, respectively.

Prior Audit Recommendations

The prior audit report for fiscal years 2003-04 and 2004-05 contained two recommendations to the office. The office implemented both recommendations.

Chapter II — Findings and Recommendations

Assets

The office did not follow state accounting policy when recording intangible assets.

In fiscal year 2005-06, the office recorded various assets on the state's asset management system as required by state accounting policy. In May of 2006, the Department of Administration issued an additional policy related to recording assets. This policy was effective July 1, 2005.

This additional policy addresses instances where costs related to capital assets are recorded using expenditure accounts that are not classified as capital outlay but are part of the asset cost, such as contracted services expenditures for developing software. The policy requires an additional accounting entry to properly record the expenditures associated with the asset on the state's accounting system. Office personnel stated the person responsible for these entries was not aware of the additional accounting entries required by the new policy and therefore did not make the necessary entries on the accounting system. Office management stated they were aware of the new policy, but misunderstood what the policy required. The table below depicts the misstatements in the State Level Activities Program on the fiscal year 2005-06 Schedule of Total Expenditures & Transfers-Out. As shown on the table, the errors are between expenditure categories. Therefore, expenditures in total are not over or under stated.

Table 1
Misstatements in the State Level Activities Program

Expenditure Account	Expenditure Schedule Amount	Over (Under) Misstatement	Correct Amount
Other Services	\$6,098,678	\$298,225	\$5,800,453
Supplies and Materials	710,046	16,925	693,121
Communication	286,855	1,600	285,255
Repair and Maintenance	66,320	5,892	60,428
Intangible Assets	7,000	(322,642)	329,642
Total	\$7,168,899	\$0	\$7,168,899

Source: Compiled by the Legislative Audit Division.

During fiscal year 2006-07 the office worked with the Department of Administration and made appropriate entries on the state's accounting system. Office personnel expect to have additional intangible assets next year and are now clear on the required accounting entries for these assets.

RECOMMENDATION #1

We recommend the office:

- A. *Implement procedures to ensure office personnel are aware of state policies related to recording assets.*
- B. *Record all required accounting entries when recording intangible assets.*

Internal Service Fund

The office is not in compliance with state regulations governing fees in its internal service fund.

The office administers an indirect cost pool through an internal service fund. The fund accumulates internal and statewide central service type costs. All of the office's state and federally funded programs are then charged a three year predetermined indirect cost rate approved by the U.S. Department of Education and the Montana Legislature to cover the costs.

Section 17-8-101(6), MCA, requires that fees deposited in an internal service fund be commensurate with costs. During our audit, we reviewed the activity in the indirect cost pool. We noted that fees were not commensurate with costs and the fund balance was not reasonable for either fiscal year included in the audit period. The following table illustrates the revenues, expenses, and fund balances for fiscal years 2005-06 and 2006-07.

Table 2
Indirect Cost Pool Revenues, Expenses and Fund Balances
for the Two Fiscal Years Ended June 30, 2007

	Fiscal Year 2005-06	Fiscal Year 2006-07
Revenues	\$1,982,536	\$2,298,325
Expenses	1,703,590	1,904,501
Excess Revenues	<u>\$ 278,946</u>	<u>\$ 393,824</u>
Ending Fund Balance	<u>\$ 403,859</u>	<u>\$ 797,653</u>

Source: Compiled by the Legislative Audit Division from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS)

Office personnel stated they were aware that fees exceeded costs. They noted this was caused by several factors. The office initiated several new programs, occupied a third building, and hired additional staff in fiscal year 2006-07. They did not know what the full impact of these additional expenses would be. Additionally, two positions were vacant for part of both fiscal year 2005-06 and fiscal year 2006-07. Office personnel expected additional personal service costs, rent, and terminations to reduce the excess revenue created by these factors. However, based on our inquiry of activity in the fund, the office did further analysis in August 2007, and determined the proposed indirect cost rate of 18.2 percent would not reduce the excess in fiscal year 2007-08. The office obtained approval from the federal government to reduce the rate to 14 percent. They anticipate the lower rate will bring fees in line with costs and reduce fund balance by the end of fiscal year 2007-08.

Office personnel should review the fund throughout the year to determine if the fees are reasonable. If at the end of a fiscal year, the fund is not in compliance with state regulations, the office should determine what rate is needed to comply and either charge a lower rate than that approved or work with the federal government to negotiate a new higher rate.

RECOMMENDATION #2

We recommend the office comply with state law by charging fees that are commensurate with costs.

Independent Auditor's Report & Office Financial Schedules

LEGISLATIVE AUDIT DIVISION

A-3

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Angie Grove

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Office of Public Instruction for each of the fiscal years ended June 30, 2007, and 2006. The information contained in these financial schedules is the responsibility of the office's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the office's assets, liabilities and cash flows.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Office of Public Instruction for each of the fiscal years ended June 30, 2007, and 2006, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 6, 2007

OFFICE OF PUBLIC INSTRUCTION
 SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
 FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Agency Fund
FUND BALANCE: July 1, 2006	\$ 16,665,421	\$ (17,125,192)	\$ (34,388)	\$ 35,139	\$ 403,858	\$ 0
PROPERTY HELD IN TRUST: July 1, 2006						\$ 31,515
ADDITIONS						
Budgeted Revenues & Transfers-In	1,196	763,171	143,302,358	146,520	2,292,350	
Nonbudgeted Revenues & Transfers-In	3,004	342,645	13,568		5,978	
Prior Year Revenues & Transfers-In Adjustments	136	(137,756)	34,992			
Direct Entries to Fund Balance	625,481,495	52,898,343	56,662			
Additions to Property Held in Trust						130,158
Total Additions	625,485,831	53,866,403	143,407,580	146,520	2,298,328	130,158
REDUCTIONS						
Budgeted Expenditures & Transfers-Out	625,603,286	55,273,947	143,380,722	137,931	1,888,033	
Nonbudgeted Expenditures & Transfers-Out		337,664		2,860	16,500	
Prior Year Expenditures & Transfers-Out Adjustments	(7,068)	(15,720)	(3,116)			
Reductions in Property Held in Trust						126,283
Total Reductions	625,596,218	55,595,891	143,377,606	140,791	1,904,533	126,283
FUND BALANCE: June 30, 2007	\$ 16,555,034	\$ (18,854,680)	\$ (4,414)	\$ 40,868	\$ 797,653	\$ 0
PROPERTY HELD IN TRUST: June 30, 2007						\$ 35,390

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF PUBLIC INSTRUCTION
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Agency Fund
FUND BALANCE: July 1, 2005	\$ 4,545,707	\$ (5,116,438)	\$ (1,274)	\$ 17,459	\$ 124,946	\$ 0
PROPERTY HELD IN TRUST: July 1, 2005						\$ 63,877
ADDITIONS						
Budgeted Revenues & Transfers-In	11,840	778,545	144,333,416	176,574	1,979,064	
Nonbudgeted Revenues & Transfers-In	868	72,000	25,000		3,472	
Prior Year Revenues & Transfers-In Adjustments		5				
Direct Entries to Fund Balance	546,266,232	60,224,571	90,064			
Additions to Property Held in Trust						110,116
Total Additions	546,278,940	61,075,121	144,448,480	176,574	1,982,536	110,116
REDUCTIONS						
Budgeted Expenditures & Transfers-Out	534,230,580	73,003,566	144,485,760	151,090	1,698,259	
Nonbudgeted Expenditures & Transfers-Out		80,309		7,804	5,365	
Prior Year Expenditures & Transfers-Out Adjustments	(71,354)		(4,166)			
Reductions in Property Held in Trust						142,478
Total Reductions	534,159,226	73,083,875	144,481,594	158,894	1,703,624	142,478
FUND BALANCE: June 30, 2006	\$ 16,665,421	\$ (17,125,192)	\$ (34,388)	\$ 35,139	\$ 403,858	\$ 0
PROPERTY HELD IN TRUST: June 30, 2006						\$ 31,515

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF PUBLIC INSTRUCTION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

TOTAL REVENUES & TRANSFERS-IN BY CLASS	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Total
Licenses and Permits		\$ 167,345				\$ 167,345
Taxes					\$ 5,978	5,978
Charges for Services		421,443		\$ 146,520	995,388	1,563,351
Sale of Documents, Merchandise and Property	\$ 1,332					1,332
Miscellaneous	3,004					3,004
Grants, Contracts, Donations and Abandonments		379,272	\$ 13,568			392,840
Other Financing Sources			4,281,881			4,281,881
Federal			139,055,469			139,055,469
Federal Indirect Cost Recoveries					1,296,962	1,296,962
Total Revenues & Transfers-In	4,336	968,060	143,350,918	146,520	2,298,328	146,768,162
Less: Nonbudgeted Revenues & Transfers-In	3,004	342,645	13,568		5,978	365,195
Prior Year Revenues & Transfers-In Adjustments	136	(137,756)	34,992			(102,628)
Actual Budgeted Revenues & Transfers-In	1,196	763,171	143,302,358	146,520	2,292,350	146,505,595
Estimated Revenues & Transfers-In	35,124	921,096	150,982,982	157,756	2,292,996	154,389,954
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (33,928)	\$ (157,925)	\$ (7,680,624)	\$ (11,236)	\$ (646)	\$ (7,884,359)
 BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS						
Licenses and Permits		\$ (355)				\$ (355)
Charges for Services		(154,298)		\$ (11,236)	\$ (612)	(166,146)
Sale of Documents, Merchandise and Property						(33,928)
Grants, Contracts, Donations and Abandonments		(3,272)	\$ (93,357)			(3,272)
Other Financing Sources			(7,587,267)			(93,357)
Federal					(34)	(7,587,267)
Federal Indirect Cost Recoveries						(34)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (33,928)	\$ (157,925)	\$ (7,680,624)	\$ (11,236)	\$ (646)	\$ (7,884,359)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF PUBLIC INSTRUCTION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

TOTAL REVENUES & TRANSFERS-IN BY CLASS	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Enterprise Fund	Internal Service Fund	Total
Licenses and Permits		\$ 165,784				\$ 165,784
Taxes					3,472	3,472
Charges for Services		84,435			879,092	1,140,101
Sale of Documents, Merchandise and Property				\$ 176,574		11,840
Miscellaneous	\$ 11,840					868
Grants, Contracts, Donations and Abandonments		600,331	\$ 25,000			625,331
Other Financing Sources			3,276,045			3,276,045
Federal			141,057,371			141,057,371
Federal Indirect Cost Recoveries					1,099,972	1,099,972
Total Revenues & Transfers-In	12,708	850,550	144,358,416	176,574	1,982,536	147,380,784
Less: Nonbudgeted Revenues & Transfers-In	868	72,000	25,000		3,472	101,340
Prior Year Revenues & Transfers-In Adjustments		5				5
Actual Budgeted Revenues & Transfers-In	11,840	778,545	144,333,416	176,574	1,979,064	147,279,439
Estimated Revenues & Transfers-In	34,923	851,799	144,745,956	176,633	1,979,082	147,788,393
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (23,083)	\$ (73,254)	\$ (412,540)	\$ (59)	\$ (18)	\$ (508,954)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS						
Licenses and Permits		\$ (2,216)				\$ (2,216)
Charges for Services		(17,569)		\$ (59)	(8)	(17,636)
Sale of Documents, Merchandise and Property						(23,083)
Grants, Contracts, Donations and Abandonments	\$ (23,083)	(53,469)				(53,469)
Other Financing Sources			\$ (1,675)			(1,675)
Federal			(410,865)			(410,865)
Federal Indirect Cost Recoveries					(10)	(10)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (23,083)	\$ (73,254)	\$ (412,540)	\$ (59)	\$ (18)	\$ (508,954)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF PUBLIC INSTRUCTION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Local Education Activities	State Level Activities	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT			
Personal Services			
Salaries		\$ 7,562,352	\$ 7,562,352
Employee Benefits		2,310,004	2,310,004
Personal Services-Other		19,117	19,117
Total		<u>9,891,473</u>	<u>9,891,473</u>
Operating Expenses			
Other Services	\$ 300	8,992,766	8,993,066
Supplies & Materials		1,035,755	1,035,755
Communications		298,034	298,034
Travel	597	931,915	932,512
Rent		473,430	473,430
Utilities		1,484	1,484
Repair & Maintenance		68,877	68,877
Other Expenses		2,614,013	2,614,013
Total	<u>897</u>	<u>14,416,274</u>	<u>14,417,171</u>
Equipment & Intangible Assets			
Equipment		123,490	123,490
Intangible Assets		24,500	24,500
Total		<u>147,990</u>	<u>147,990</u>
Local Assistance			
From State Sources	669,522,193	15,496	669,537,689
From Other Income Sources	332,145		332,145
Total	<u>669,854,338</u>	<u>15,496</u>	<u>669,869,834</u>
Grants			
From State Sources	1,572,476	169,651	1,742,127
From Federal Sources	130,545,942	(575)	130,545,367
Total	<u>132,118,418</u>	<u>169,076</u>	<u>132,287,494</u>
Transfers			
Accounting Entity Transfers		1,077	1,077
Total		<u>1,077</u>	<u>1,077</u>
Total Expenditures & Transfers-Out	<u>\$ 801,973,653</u>	<u>\$ 24,641,386</u>	<u>\$ 826,615,039</u>
EXPENDITURES & TRANSFERS-OUT BY FUND			
General Fund	\$ 616,184,093	\$ 9,412,125	\$ 625,596,218
State Special Revenue Fund	55,265,806	330,085	55,595,891
Federal Special Revenue Fund	130,523,754	12,853,852	143,377,606
Enterprise Fund		140,791	140,791
Internal Service Fund		1,904,533	1,904,533
Total Expenditures & Transfers-Out	<u>801,973,653</u>	<u>24,641,386</u>	<u>826,615,039</u>
Less: Nonbudgeted Expenditures & Transfers-Out	332,921	24,102	357,023
Prior Year Expenditures & Transfers-Out Adjustments	(17,705)	(8,198)	(25,903)
Actual Budgeted Expenditures & Transfers-Out	<u>801,658,437</u>	<u>24,625,482</u>	<u>826,283,919</u>
Budget Authority	834,668,983	25,506,643	860,175,626
Unspent Budget Authority	<u>\$ 33,010,546</u>	<u>\$ 881,161</u>	<u>\$ 33,891,707</u>
UNSPENT BUDGET AUTHORITY BY FUND			
General Fund	\$ 22,379,362	\$ 6,984	\$ 22,386,346
State Special Revenue Fund	15,970	39,854	55,824
Federal Special Revenue Fund	10,615,214	819,749	11,434,963
Enterprise Fund		909	909
Internal Service Fund		13,665	13,665
Unspent Budget Authority	<u>\$ 33,010,546</u>	<u>\$ 881,161</u>	<u>\$ 33,891,707</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

OFFICE OF PUBLIC INSTRUCTION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Local Education Activities	State Level Activities	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT			
Personal Services			
Salaries		\$ 6,498,401	\$ 6,498,401
Employee Benefits		1,898,762	1,898,762
Personal Services-Other		10,964	10,964
Total		<u>8,408,127</u>	<u>8,408,127</u>
Operating Expenses			
Other Services	\$ 130	6,098,678	6,098,808
Supplies & Materials		710,046	710,046
Communications		286,855	286,855
Travel	837	806,252	807,089
Rent		390,899	390,899
Utilities		536	536
Repair & Maintenance		66,320	66,320
Other Expenses		2,424,459	2,424,459
Total	<u>967</u>	<u>10,078,045</u>	<u>10,785,012</u>
Equipment & Intangible Assets			
Equipment		110,792	110,792
Intangible Assets		7,000	7,000
Total		<u>117,792</u>	<u>117,792</u>
Local Assistance			
From State Sources	600,076,305	25,827	600,102,132
Total	<u>600,076,305</u>	<u>25,827</u>	<u>600,102,132</u>
Grants			
From State Sources	1,122,383		1,122,383
From Federal Sources	133,051,192	575	133,051,767
Total	<u>134,173,575</u>	<u>575</u>	<u>134,174,150</u>
Total Expenditures & Transfers-Out	\$ <u>734,250,847</u>	\$ <u>19,336,366</u>	\$ <u>753,587,213</u>
EXPENDITURES & TRANSFERS-OUT BY FUND			
General Fund	\$ 528,454,477	\$ 5,704,749	\$ 534,159,226
State Special Revenue Fund	72,720,178	363,697	73,083,875
Federal Special Revenue Fund	133,076,192	11,405,402	144,481,594
Enterprise Fund		158,894	158,894
Internal Service Fund		1,703,624	1,703,624
Total Expenditures & Transfers-Out	<u>734,250,847</u>	<u>19,336,366</u>	<u>753,587,213</u>
Less: Nonbudgeted Expenditures & Transfers-Out	(776)	94,254	93,478
Prior Year Expenditures & Transfers-Out Adjustments	(71,829)	(3,691)	(75,520)
Actual Budgeted Expenditures & Transfers-Out	<u>734,323,452</u>	<u>19,245,803</u>	<u>753,569,255</u>
Budget Authority	896,837,232	23,198,730	920,035,962
Unspent Budget Authority	<u>\$ 162,513,780</u>	<u>\$ 3,952,927</u>	<u>\$ 166,466,707</u>
UNSPENT BUDGET AUTHORITY BY FUND			
General Fund	\$ 21,374,920	\$ 2,781,546	\$ 24,156,466
State Special Revenue Fund	103,581	23,062	126,643
Federal Special Revenue Fund	141,035,279	1,080,029	142,115,308
Enterprise Fund		17,322	17,322
Internal Service Fund		50,968	50,968
Unspent Budget Authority	<u>\$ 162,513,780</u>	<u>\$ 3,952,927</u>	<u>\$ 166,466,707</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Office of Public Instruction

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2007

1. Summary of Significant Accounting Policies

Basis of Accounting

The office uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, and Federal Special Revenue). In applying the modified accrual basis, the office records:

- ♦ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ♦ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the office to record the cost of employees' annual and sick leave when used or paid.

The office uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary (Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the office records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the office receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The office uses the following funds:

Governmental Fund Category

- ♦ **General Fund** – to account for all financial resources except those required to be accounted for in another fund.
- ♦ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are

legally restricted to expenditures for specific state program purposes. Office State Special Revenue Funds include traffic safety education and distributions of state support to schools made through the Guarantee Account.

- ♦ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Office Federal Special Revenue Funds account for the Title I, Title II, Child Nutrition and Commodities, Individuals with Disabilities Education Act, and various other federal grants.

Proprietary Fund Category

- ♦ **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The office's Internal Service Fund contains its indirect cost pool, which is used to fund internal and statewide central service type costs such as payroll service fees, accounting services, and audit fees.
- ♦ **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the office finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes of similar revenues. Office Enterprise Funds include the advanced driver's education program.

Fiduciary Fund Category

- ♦ **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal clearing account activity but these must have a zero balance at fiscal year-end. The office records custodial cash accounts for student vocational education organizations in the Agency Fund.

2. General Fund Balance

The office has authority to pay obligations from the statewide General Fund within its appropriation limits. The office's total assets placed in the fund exceed outstanding liabilities, resulting in a positive ending General Fund balance for the fiscal years ended June 30, 2007, and 2006. The balance reflects the results of the activity of the office and not the fund balance of the statewide General Fund.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General, State Special Revenue, and Federal Special Revenue funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

4. Guarantee Account

The negative fund balance in the State Special Revenue Fund at June 30, 2007, and 2006 does not indicate overspent appropriation authority. The office pays obligations from the Guarantee Account, yet the revenue designated to fund the obligations is not included on the office's financial schedules because it is collected by the Department of Natural Resources and Conservation (DNRC). The DNRC is responsible for the revenue distributions to this fund. DNRC recorded revenue in the Guarantee Account totaling \$64,807,881 and \$48,966,447 in fiscal years 2005-06 and 2006-07, respectively.

5. Unspent Authority

The \$141,035,279 of unspent budget authority in the Federal Special Revenue Fund in the Local Education Activities program in fiscal year 2005-06 relates to the office's appropriation for federal programs. The office has a biennial appropriation for their federal programs. Unspent authority in the first year of the biennium is available and used for expenditures in the second year of the biennium.

OFFICE OF PUBLIC
INSTRUCTION

OFFICE RESPONSE



— Montana Office of Public Instruction

Linda McCulloch
State Superintendent

RECEIVED

OCT 11 2007

LEGISLATIVE AUDIT DIV.

October 10, 2007

TO THE LEGISLATIVE AUDIT COMMITTEE OF THE MONTANA STATE
LEGISLATURE

Following is our response to recommendations contained in the Office of Public Instruction's (OPI) 2006-2007 audit report.

Recommendation #1

We recommend the office:

- A. Implement procedures to ensure office personnel are aware of state policies related to recording assets.
- B. Record all required accounting entries when recording intangible assets.

OPI response: We concur. We understand that our office was among many agencies that did not apply the policy correctly in the initial year it was announced. We now understand the policy and have been following it. Department of Administration staff was helpful to OPI's accounting staff in understanding and applying the correct procedures during fiscal year 2006-07.

Recommendation #2

We recommend the office comply with state law by charging fees that are commensurate with costs.

OPI response: We concur. The new indirect cost rate approved in August 2007 was reduced in order to use down funds by fiscal year end 2007-08 to an acceptable working capital level. For the future, the federal Department of Education has agreed we may apply a lower rate than they have approved during a rate period, if necessary, to maintain a working capital balance within the acceptable range. This gives the office much more flexibility to moderate the fund's balance. We note, however, that costs of the indirect cost pool include termination payouts for staff, which can be highly unpredictable, may be quite large in any given year, and may occur very late in the fiscal year, making it difficult to accurately predict and manage the ending balance of the fund.

Sincerely,

Linda McCulloch
State Superintendent

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